

REVISED AGENDA — March 14, 2000 Business Taxes Committee Meeting
Proposed Amendments to Clarify Application of Tax to Leases of Houseboats Under Regulation 1661, Mobile Transportation Equipment

<p>Action 1 — Consent Item – Application of tax to leases of houseboats.</p> <p>Proposal to amend Regulation 1661(a)(1); <i>Mobile Transportation Equipment</i>, (MTE) by incorporating the list of MTE specified in Revenue and Taxation Code (RTC) section 6023.</p>	<p>Adopt staff's proposed amendment. Water Resorts has no objections to this proposed amendment.</p> <p style="text-align: right;">Operative Date: None. Implementation: Upon OAL approval.</p>
<p>Action 2 — Classification of Houseboats</p>	<p>Adopt either:</p> <div style="display: flex; justify-content: space-between;"> <div style="width: 10%;">or</div> <div style="width: 80%;"> <p>1) Staff's recommendation to amend Regulation 1661(a)(5) to provide that houseboats are not ships and, therefore, not MTE.</p> <p style="text-align: right;">Operative Date: None. Implementation: Upon OAL approval.</p> </div> </div> <div style="display: flex; justify-content: space-between;"> <div style="width: 10%;">or</div> <div style="width: 80%;"> <p>2) Water Resorts' proposal to make no changes to Regulation 1661(a)(5), but administratively recognize that houseboats for use in transporting persons or property are MTE when 30 feet or more in length, with no operative date.</p> <p style="text-align: right;">Operative Date: None. Implementation: Upon Board approval.</p> </div> </div> <div style="display: flex; justify-content: space-between;"> <div style="width: 10%;">or</div> <div style="width: 80%;"> <p>3) If the Board concludes that houseboats are ships and, thus, MTE when 30 feet or more in length, adopt staff recommended amendments to Regulation 1661(a)(5) as drafted by staff. The change will apply prospectively to houseboats purchased on or after the operative date.</p> <p style="text-align: right;">Operative Date: January 1, 2001. Implementation: Upon OAL approval.</p> </div> </div>
<p>Action 3 — Authorization to Publish (whichever language is adopted)</p>	<p>Direct the publication of the proposed amendments to Regulation 1661 as adopted in the above actions.</p>

REVISED AGENDA — March 14, 2000 Business Taxes Committee Meeting
Proposed Amendments to Clarify Application of Tax to Leases of Houseboats Under Regulation 1661, Mobile Transportation Equipment

Formal Issue Paper Number 00 - 005

Action Item	Staff's Proposed Regulatory Language
<p>Action 1 — Consent Item</p> <p>Proposal to amend Regulation 1661(a)(1); <i>Mobile Transportation Equipment</i>, (MTE) by incorporating the list of MTE specified in Revenue and Taxation Code (RTC) section 6023. Exhibit 2, Page 1</p>	<p>Regulation 1661</p> <p>(a) Definitions.</p> <p>(1) “<i>Mobile Transportation Equipment</i>”. The term “mobile transportation equipment” includes only equipment for use in transporting persons or property for substantial distances, <u>such as railroad cars and locomotives, buses, trucks (except “one-way rental trucks”), truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment.</u></p>

REVISED AGENDA — March 14, 2000 Business Taxes Committee Meeting
Proposed Amendments to Clarify Application of Tax to Leases of Houseboats Under Regulation 1661, Mobile Transportation Equipment

Formal Issue Paper Number 00 - 005

Action Item	Current Regulatory Language	Staff's Proposed Language (Recommended)	Water Resorts Proposed Language (Alternate 1)	Staff Drafted Language (Alternate 2)
Action 2 - Classification of Houseboats Exhibit 2, Page 2	Regulation 1661 (a) Definitions. (5) "Ships" The term "ships" includes vessels 30 feet or more in length. The term does not include vessels less than 30 feet in length.	Regulation 1661 (a) Definitions. (5) "Ships" The term "ships" includes vessels 30 feet or more in length <u>for use in transporting persons or property for substantial distances.</u> The term does not include vessels less than 30 feet in length, <u>or houseboats, whether or not they are 30 feet or more in length.</u>	<i>No Change to the Existing Regulation</i>	Regulation 1661 (a) Definitions. (5) "Ships" The term "ships" includes vessels <u>such as trawlers, fishing boats, sailboats, and yachts</u> 30 feet or more in length. <u>The term also includes houseboats 30 feet or more in length that are purchased on or after January 1, 2001.</u> The term does not include vessels less than 30 feet in length.

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- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

Application of Tax to Leases of Houseboats Under Regulation 1661, *Mobile Transportation Equipment*

I. Issue

Should Regulation 1661 be amended to clarify the application of sales and use tax to leases of houseboats and incorporate the list of mobile transportation equipment (MTE) specified in Revenue and Taxation Code (RTC) section 6023?

II. Staff Recommendation

Staff recommends that Regulation 1661, *Mobile Transportation Equipment*, be amended to provide that houseboats are not ships and, therefore, not MTE. Staff also recommends that the list of MTE specified in RTC section 6023 be incorporated into the regulation. Staff recommends no operative date, since the proposed amendments simply put into the regulation the Board's longstanding interpretation of the existing statute.

III. Other Alternative(s) Considered

A. Alternative 1

As proposed by Mr. David Smith, Water Resorts, Inc., (hereafter Water Resorts), do not amend Regulation 1661, *Mobile Transportation Equipment*; rather, administratively recognize that houseboats for use in transporting persons or property are MTE when 30 feet or more in length. Water Resorts proposes no operative date, since they contend that the existing regulation has been misinterpreted and this would be an administrative reinterpretation of the existing statute.

B. Alternative 2

If the Board concludes that houseboats are ships and, thus, are MTE when 30 feet or more in length, staff recommends amendments to Regulation 1661(a)(5) be adopted as drafted by staff. If this alternative is adopted, staff strongly recommends an operative date of January 1, 2001, for purchases of houseboats made on or after this date, since this amendment is a change to staff's longstanding treatment of houseboats as non-MTE and in recognition of taxpayers' reliance on this longstanding treatment. Staff also recommends the list of MTE specified in RTC section 6023 be incorporated into Regulation 1661(a)(1), with no operative date.

IV. Background

Under the Sales and Use Tax Law, the application of tax to leases of MTE is different than the application of tax to leases of other tangible personal property. While the lease of non-MTE tangible personal property is a continuing sale and purchase under circumstances specified in RTC sections 6006(g)(5) and 6010(e)(5), with tax being imposed only for the period during which the property is located in California, leases of MTE are never sales and purchases and the imposition of tax does not depend on where the property is located during the lease. Instead, RTC sections 6006(g)(4) and 6010(e)(4) specifically exclude leases of MTE from the definitions of sale and purchase.

MTE is defined by RTC section 6023 as follows:

“Mobile transportation equipment” includes equipment such as railroad cars and locomotives, buses, trucks (except “one-way rental trucks”), truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment.

Since the sale of the equipment to the lessor of MTE is a retail sale, lessors of MTE are consumers of the MTE they lease and tax is generally due on the purchase price of such MTE. However, RTC section 6094(c) provides persons, whose use of MTE will be limited to leasing, an election to pay their use tax liability measured by the fair rental value of the leased equipment. This election must be made on or before the due date of the return for the period in which the equipment is first leased. If the election is not made timely, the option to make the election is lost and tax is due on the purchase price of the equipment.

Discussion – Regulation 1661, Mobile Transportation Equipment

First adopted in January 1970, Regulation 1661, *Mobile Transportation Equipment*, explains how the Sales and Use Tax Law applies to leases of MTE. Regulation 1661 provides that MTE includes only equipment for use in transporting persons or property for substantial distances, including ships, but specifically excludes some items, such as passenger vehicles, and trailers and baggage containers designed for hauling by passenger vehicles. The regulation defines ships to include vessels 30 feet or more in length. Therefore, vessels for use in transporting persons or property substantial distances are MTE if they are 30 feet or more in length. However, if vessels are 30 feet or more in length, they are not MTE if they are not for use in transporting persons or property substantial distances.

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Based on the statutes then in effect, Regulation 1661 as first adopted specifically defined MTE as equipment used in for-hire transportation of property in interstate or foreign commerce. Thus, leases of equipment typically used in transporting property across state or national boundaries were treated differently than other leases of tangible personal property, so that tax imposed on these equipment leases did not depend on whether the equipment was located inside or outside of California. If not for the special rules for MTE, a taxable lease of a railroad car, for example, would be subject to tax if in California for a few days, not subject to tax after it leaves California, and then subject to tax again when it returns to California. Subsequent changes to the regulation following amendments to RTC sections 6006 and 6010 removed the interstate or foreign commerce requirement (1970); allowed for the transportation of persons as well as property (1970); included leases of buses, aircraft, and ships (1970); and removed the “for-hire” requirement from the definition (1972).

Regulation 1661 was amended in 1983 to define “ship” to include vessels 30 feet or more in length, but not vessels less than 30 feet in length, based on a 1973 interpretation reflected in Business Taxes Law Guide Annotation 335.0040 (3/31/73). Staff’s opinion was that “ship” should be interpreted only to mean the type of equipment that is commonly used for transporting persons or property substantial distances, and looked to Coast Guard requirements for documented vessels in an effort to establish footage or tonnage guidelines. The Coast Guard advised that, as a general rule, the 5 net ton limit for requiring vessels to be documented translates to a vessel 5 feet deep, 8 feet wide and 30 feet in length (calculated at 100 cubic feet per ton) and informed staff that vessels less than 30 feet in length would not commonly be used in commercial operations for carrying persons or property on the high seas or for substantial distances. However, houseboats, regardless of length, are normally used on lakes or bays and are not the kind of property that are designed to carry persons or property substantial distances. Accordingly, staff concluded that houseboats were not MTE even if over 30 feet, and that leases of houseboats should, therefore, be treated as leases of other tangible personal property, like pilot or tugboats.

Persons who purchase houseboats for lease may choose to pay tax on cost or on rentals, regardless of whether the houseboats are or are not MTE. In the case of MTE, the lessor may elect to pay tax on the “fair rental value.” If the lessor does not pay tax on cost or rental receipts (fair rental value), tax is due on rental receipts if houseboats are not MTE, but tax must be assessed on the purchase price if houseboats were to be classified as MTE. If qualifying houseboats are considered MTE, and the lessor elects to pay tax on the fair rental value, the lessor must continue to pay California tax if the houseboat is moved to another state and leased there. Under the current interpretation that houseboats are not MTE, the lease of a houseboat removed from the state is no longer subject to California use tax on rental receipts as long as it remains outside California.

FORMAL ISSUE PAPERIssue Paper Number 00 - 005**Discussion – Substantial Distance**

In their letter dated January 20, 2000, Water Resorts stated that staff's interpretation of the meaning of "equipment for use in transporting persons or property for substantial distances," which is the prime reason behind staff's opinion that houseboats are not MTE, is inconsistent with the various other administrative interpretations on the subject. Water Resorts cited several examples of Board interpretations where equipment did not move, yet was still considered MTE because it was capable of moving, and examples of what constituted a "substantial distance." Water Resorts contends that houseboats are capable of traveling substantial distances (100 miles or more during a week or weekend lease) and are available for lease on both large lakes and the Delta, which has over 1,000 miles of waterways. Water Resorts believes that since houseboats do move persons or property substantial distances, they should be classified as MTE.

In its interpretative opinions, staff has set standards to determine whether equipment constitutes MTE. Vehicles are evaluated on whether they are capable of traveling substantial distances at highway speed. There is not such a straightforward evaluation available for ships; however, staff has looked at the fuel capacity and the navigability of the waterways to determine whether ships constitute MTE. Regulation 1661(a)(1) defines short distance moving as being within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport. Houseboats leased on inland lakes have not been considered the kind of equipment designed to carry persons or property substantial distances. Houseboats leased on the Delta, a network of fresh-water rivers, tributaries and channels flowing into San Francisco Bay, have access to an extensive system of navigable waterways. However, houseboats are generally not found in the larger bays or at sea because they typically are not designed to be seagoing vessels or to navigate rough waters. Many companies leasing houseboats in the Delta limit the areas to which lessees may take houseboats, not allowing them further west than the Antioch Bridge due to the houseboat's difficulty in navigating the frequently rough waters beyond that point.

Discussion – Houseboat vs. Yacht

Water Resorts also believes that there is no relevant difference between a houseboat and a trawler, sport fishing boat, sailboat or yacht, and there should be no difference in the treatment of houseboats for sales and use tax purposes. This has been reiterated in letters dated January 10, 2000, January 20, 2000, and January 25, 2000, and at the interested parties' meeting held January 18, 2000. In their January 25, 2000 letter, Water Resorts provided copies of advertisements and articles showing different types of houseboats and yachts and the similarities among them. These vessels all had sleeping, cooking and restroom facilities, and each was capable of being used as a place of habitation.

In evaluating the examples provided by Water Resorts, the significant difference between the example vessels and houseboats was the ability of vessels other than houseboats to travel in rougher bodies of water, such as bays, coastal waters and the open ocean. While houseboats share

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some of the same design features and accommodations as motor yachts, sailboats and trawlers, their structure and hull designs make them unable to navigate rough waters and, therefore, limit them to confined areas of water. Also, most houseboats are leased for recreational purposes, returning to their originating point upon completion of the rental, and not leased for transportation from one point to another.

Discussion – Effects of an Operative Date

Staff's proposed amendment to Regulation 1661 (classifying houseboats as TPP) includes no operative date since the proposed amendment is based on the current and longstanding administrative interpretation of the existing statute. Since there is no change in the manner in which the sale and use of houseboats are taxed, staff's proposed amendment would not create any negative tax consequences for current lessors of houseboats. Water Resorts' proposed amendment to Regulation 1661 (classifying houseboats as MTE), without an operative date, could have negative tax consequences for some lessors of houseboats since it represents a change in the Board's longstanding treatment of houseboats as non-MTE.

If Alternative 1 is adopted, houseboat lessors who previously elected to pay tax based on lease receipts would now owe tax based on fair rental value. If the lessor removes the houseboat from California, placing it into lease service in another state, tax would continue to be due on fair rental value, regardless of the fact that the houseboat is no longer in California. Under the current treatment of houseboats as TPP, if a lessor had placed a houseboat into lease service outside of California for more than 90 days, then decided to place that houseboat into lease service in California, they would be required to report tax based on lease receipts. However, in the same situation, if houseboats are retroactively classified as MTE, no tax would be due and lessors would have overreported any tax previously reported on lease receipts. Lessors may be able to file a claim for refund for overpaid tax for periods still within the statute of limitations, based on the provisions of Regulation 1700, *Reimbursement for Sales Tax*. These various unplanned tax consequences are eliminated for prior periods in Alternative 2 by the inclusion of an operative date. Staff believes that classifying houseboats as MTE requires an operative date, as this would be a change in the Board's longstanding interpretation and taxpayers' longstanding reliance on the present administrative interpretation.

V. Staff Recommendation**A. Description of the Staff Recommendation**

Staff recommends that Regulation 1661, *Mobile Transportation Equipment*, be amended to provide that houseboats are not ships and, therefore, not MTE. Staff also recommends that

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the list of MTE specified in RTC section 6023 be incorporated into the regulation. Staff recommends no operative date, since the proposed amendments simply put into the regulation the Board's longstanding interpretation of the existing statute. Implementation of the proposed amendments will be upon OAL approval.

B. Pros of the Staff Recommendation

- Provides clarity in the application of tax to leases of houseboats.
- Provides consistent treatment of houseboats regardless of length.
- Requires no special notification of taxpayers or staff, as this has been the administrative policy of the Board for more than 25 years.
- Provides taxpayers with a list of MTE specified in RTC section 6023.

C. Cons of the Staff Recommendation

- Creates a distinction between houseboats and motor yachts for sales and use tax purposes.
- Weakens the bright line test of 30 feet in length for vessels to qualify as ships.

D. Statutory or Regulatory Change

No statutory change is required, but requires amendments to Regulation 1661.

E. Administrative Impact

None.

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F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None. (See Revenue Estimate, Exhibit 1)

G. Taxpayer/Customer Impact

None. The Board has administratively considered houseboats as tangible personal property for more than 25 years.

H. Critical Time Frames

There is no operative date for the staff recommendation. The proposed amendment to 1661(a)(1) incorporates existing statutory language into the regulation and the proposed amendment to 1661(a)(5) is based on the current administrative interpretation of the existing statute. Implementation will be upon OAL approval.

VI. Alternative 1

A. Description of the Alternative

As proposed by Mr. David Smith, Water Resorts, Inc., do not amend Regulation 1661, *Mobile Transportation Equipment*; rather, administratively recognize that houseboats for use in transporting persons or property are MTE when 30 feet or more in length. Water Resorts proposes no operative date, since they contend that the existing regulation has been misinterpreted and this would be an administrative reinterpretation of the existing statute. Implementation will be upon Board approval.

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B. Pros of Alternative

- Provides consistent treatment of houseboats and motor yachts for sales and use tax purposes.
- Requires no regulatory change.

C. Cons of the Alternative

- Does not provide clarity for the application of tax to leases of houseboats within Regulation 1661.
- Creates a distinction between houseboats that are less than 30 feet in length and those that are 30 feet or more in length.
- Reverses Annotation 335.0040 and staff's longstanding interpretation that houseboats (regardless of length) are not MTE, which taxpayers and staff have relied on for over 25 years, therefore requires notification of taxpayers and staff.
- Does not incorporate the list of MTE specified in RTC section 6023 into Regulation 1661.

D. Statutory or Regulatory Change

No statutory or regulatory change is required.

E. Administrative Impact

Because this alternative would reverse staff's longstanding interpretation, notification of taxpayers and staff would be necessary.

F. Fiscal Impact

1. Cost Impact

The cost to notify affected taxpayers and staff would be absorbable.

FORMAL ISSUE PAPERIssue Paper Number 00 - 005**2. Revenue Impact**

The revenue loss from administratively recognizing houseboats of 30 feet or more in length as MTE is estimated to be less than \$250,000. The effect of this proposal would be retroactive and would create a potential for refunds or assessments for three years.

G. Taxpayer/Customer Impact

Minor. While the number of houseboat lessors in California is estimated by staff to be fewer than 50, the retroactive reclassification of houseboats from TPP to MTE could cause unplanned tax consequences for these taxpayers who have relied on staff's longstanding interpretation that houseboats are not MTE.

H. Critical Time Frames

This alternative has no operative date since Water Resorts contends that the existing regulation has been misinterpreted and this would be an administrative reinterpretation of the existing statute. This alternative would be retroactive. Notification of taxpayers and staff would be necessary. This alternative would be implemented upon approval of the Board. If approved, staff would be notified of this change by memo and houseboat lessors would be notified by a direct mailing.

VII. Alternative 2**A. Description of the Alternative**

If the Board concludes that houseboats are ships and, thus, are MTE when 30 feet or more in length, staff recommends amendments to Regulation 1661(a)(5) be adopted as drafted by staff. If this alternative is adopted, staff strongly recommends an operative date of January 1, 2001, for houseboats purchased on or after this date, since this amendment is a change to staff's longstanding treatment of houseboats as non-MTE and in recognition of taxpayers' reliance on this longstanding interpretation. Staff also recommends the list of MTE specified in RTC section 6023 be incorporated into Regulation 1661(a)(1), with no operative date. Implementation of the proposed amendments will be upon OAL approval.

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B. Pros of the Alternative

- Provides clarity in the application of tax to leases of houseboats.
- Provides consistent treatment of houseboats and motor yachts for sales and use tax purposes.

C. Cons of the Alternative

- Creates a distinction between houseboats that are less than 30 feet in length and those that are 30 feet or more in length.
- Requires notification of taxpayers and staff of the change in the application of tax to leases of houseboats.
- Reverses Annotation 335.0040 and staff's longstanding administrative interpretation that houseboats, regardless of length, are not MTE, which taxpayers have relied on for over 25 years.

D. Statutory or Regulatory Change

No statutory change is required, but requires an amendment to Regulation 1661.

E. Administrative Impact

Because the amendment proposed under this alternative would reverse staff's longstanding interpretation, notification of taxpayers and staff would be necessary.

F. Fiscal Impact

1. Cost Impact

The cost to notify affected taxpayers would be absorbable.

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2. Revenue Impact

The revenue loss from amending Regulation 1661 to define houseboats as ships and therefore MTE if 30 feet or more in length is estimated to be less than \$250,000. This alternative includes an operative date of January 1, 2001; therefore, there would be no refunds.

G. Taxpayer/Customer Impact

Minor. While the number of houseboat lessors in California is estimated by staff to be fewer than 50, the reclassification of houseboats 30 feet or more in length from TPP to MTE could cause unplanned tax consequences for these taxpayers who have relied on staff's longstanding interpretation that houseboats of any length are not MTE. Inclusion of the operative date recommended by staff eliminates any unplanned tax consequences.

H. Critical Time Frames

Language drafted by staff for this alternative includes an operative date of January 1, 2001. Prospective treatment is in recognition of staff's longstanding treatment of houseboats as non-MTE and taxpayers' reliance on this interpretation. Retroactive treatment could have negative tax consequences for some houseboat lessors. This alternative would be implemented upon approval of OAL. If approved, staff would be notified by memo and houseboat lessors would be notified by a direct mailing.

Prepared by: Program Planning Division
Sales and Use Tax Department

Current as of: March 13, 2000

BOARD OF EQUALIZATION
REVENUE ESTIMATE

**APPLICATION OF TAX TO LEASES OF HOUSEBOATS UNDER
REGULATION 1661, *MOBILE TRANSPORTATION EQUIPMENT*****Staff Recommendation**

Staff recommends that Regulation 1661, *Mobile Transportation Equipment*, be amended to provide that houseboats are not ships and therefore, not MTE. Staff also recommends that the list of MTE specified in RTC section 6023 be incorporated into the regulation. Staff recommends no operative date, since the proposed amendments simply put into the regulation the Board's longstanding interpretation of existing statute. Implementation of the proposed amendment will be upon approval of the Office of Administrative Law (OAL).

Alternative 1:

As proposed by Mr. David Smith, Water Resorts, Inc., (hereafter Water Resorts), do not amend Regulation 1661, *Mobile Transportation Equipment*; rather, administratively recognize that houseboats for use in transporting persons or property are MTE when 30 feet or more in length. Water Resorts proposes no operative date, since they contend that the existing regulation has been misinterpreted and this would be an administrative reinterpretation of the existing statute. Implementation will be upon Board approval.

Alternative 2:

If the Board concludes that houseboats are ships and, thus, are MTE when 30 feet or more in length, staff recommends amendments to Regulation 1661(a)(5) be adopted as drafted by staff. If this alternative is adopted, staff strongly recommends that the change operate prospectively for houseboats purchased on or after January 1, 2001, since this amendment is a change to staff's longstanding treatment of houseboats as non-MTE and in recognition of taxpayers' reliance on this longstanding treatment. Staff also recommends the list of MTE specified in RTC section 6023 be incorporated into Regulation 1661(a)(1), with no operative date. Implementation of the proposed amendment will be upon OAL approval.

Background, Methodology, and Assumptions

Staff Recommendation:

The staff recommendation would amend Regulation 1661 to clarify current administrative interpretation regarding houseboats. The staff recommendation has no revenue effect.

Alternative 1:

Alternative 1 would administratively classify houseboats over 30 feet in length as MTE. There are a number of differences in tax application between leases of MTE and leases of other tangible personal property (TPP).

Purchase Price vs. Lease Receipts

Persons who purchase either MTE or other TPP can elect to pay tax on the purchase price or on lease receipts/fair rental value. However, if a lessor of MTE fails to make a timely election to pay on fair rental value, he loses the option to pay tax on fair rental value and must pay tax on the purchase price. A lessor of other TPP who fails to make a timely election to pay on purchase price must pay tax based on lease receipts. Thus, the tax owed by a lessor who fails to make a timely election depends on whether the property is MTE or other TPP. If the property is MTE, the lessor would have to pay tax based on purchase price; if the property is other TPP, the lessor would be required to report tax on rental receipts. Since houseboats are not currently regarded as MTE, a lessor who fails to make a timely election would owe tax on rental receipts. If houseboats were instead regarded as MTE, a lessor who fails to make a timely election would instead owe tax on purchase price.

Water Resorts states that on a normal houseboat put into lease service, they recover 50% of the cost of the houseboat each year. They keep the houseboat in lease service for an average of ten years and then sell the houseboats for 50% of the original cost. The average life of a houseboat is 20 years. Therefore, in the long run more tax would be paid based on lease receipts than would be paid based on purchase price, changing the classification of houseboats to MTE could result in a loss of sales and use tax revenue from those lessors who fail to make a timely election to pay based on fair rental value.

Fair Rental Value vs. Rentals Payable

When the lessor of MTE does not timely elect to pay tax based on "fair rental value", tax is due on the purchase price. Fair rental value is normally the amount of lease receipts. However, the lessor is liable for the tax regardless of whether the lessee makes payment to the lessor.

When the lessor of other TPP does not timely elect to pay tax based on purchase price, tax is due on "lease receipts". If the lessee does not make the lease payments, the lessor is not liable for the tax.

Since the tax is due on leases of MTE regardless of whether the lessor collects payment, changing the classification of houseboats to MTE could result in a gain of sales and use tax revenue.

Property Removed From The State

On leases of MTE, when the lessor elects to pay tax based on fair rental value, the lessor must continue to report on this basis even if the property is removed from the state.

On leases of other TPP, if the lessor does not elect to pay tax on purchase price such that tax is due based on lease receipts, those lease receipts are no longer taxable when the property is removed from the state.

Since tax is due on leases of MTE even if the property is removed from the state, changing the classification of houseboats to MTE could result in a gain of sales and use tax revenue.

Property Brought Into The State

For TPP purchased outside California and first placed into rental service outside the state for more than 90 days prior to entry into California, the application of tax differs between leases of MTE and leases of other TPP. For such leases of TPP other than MTE, tax would be due on lease receipts, while for such leases of MTE, no tax would be due on either cost or fair rental value. Changing the classification of houseboats to MTE would result in a loss of sales and use tax revenue under these conditions.

To summarize, changing the classification of houseboats to MTE would result in the following revenue effects:

<u>Situation</u>	<u>Revenue Effect</u>
1. Lessor fails to make election	Revenue loss
2. Lessor elects to pay on fair rental value	Revenue gain
3. Houseboats removed from state	Revenue gain
4. Houseboats brought into state	Revenue loss

The Sales and Use Tax Department (SUTD) estimates that there are fewer than 50 businesses that lease houseboats in California. An analysis of a number of these businesses indicates that the majority of houseboat lessors elect to pay tax based on purchase price. Changing the classification of these houseboats to MTE would have no effect on sales and use tax revenues

For those lessors who do not elect to pay tax on purchase price, the tax consequences depend on the above situations. For the first three situations enumerated above, it is estimated that the revenue effect, whether a gain or a loss, would not be significant.

For those houseboats purchased and placed into rental service out of state and brought into the state after more than 90 days of functional use, the revenue impact could be substantial. Houseboats cost approximately \$150,000 and the sales and use tax at the basic rate of 7.25% for such a sale would amount to \$10,875. The tax generated on the rental receipts from the lease of such a houseboat would be somewhat more than this amount. We have no way of knowing how many houseboats would fall into this category. However, since there are relatively few houseboats brought into California that would meet these criteria, it is estimated that the total revenue loss would be less than \$250,000.

Since this proposal has no operative date and would be retroactive, there is a potential for refunds or additional assessments for 3 years.

Alternative 2:

Alternative 2 would amend Regulation 1661 to clarify that houseboats are defined as ships when 30 feet or more in length. As such, houseboats would be considered MTE.

The revenue effect of this proposal is the same as alternative 1. However, this proposal does include an operative date of January 1, 2001. Therefore, this proposal would not be retroactive and no claims for refunds could be filed nor could additional assessments be made.

Revenue Summary**Staff Recommendation:**

The staff recommendation has no revenue effect.

Alternative 1:

The revenue loss from administratively recognizing houseboats as mobile transportation equipment is estimated to be less than \$250,000.

The effect of this proposal would be retroactive and would create a potential for refunds or additional assessments for 3 years.

Alternative 2:

The revenue loss from amending Regulation 1661 to define houseboats as ships and therefore to classify them as mobile transportation equipment is estimated to be less than \$250,000.

The proposal contains an operative date of January 1, 2001; therefore, there would be no refunds or additional assessments.

Preparation

This revenue estimate was prepared by David E. Hayes, Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Freda Orendt-Evans, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of March 2, 2000

**Application of Tax to Leases of Houseboats under Regulation
1661, Leases of Mobile Transportation Equipment
Comparison of Current and Proposed Language**

Revised as of March 13, 2000

Action Item	Current Regulatory Language	Staff's Proposed Language (Recommended)	Water Resorts Proposed Language (Alternate 1)	Staff Drafted Language (Alternate 2)	Summary Comments
ACTION 1 — CONSENT 1. Add examples of mobile transportation equipment from RTC Section 6023	Regulation 1661 (a) Definitions. (1) "Mobile Transportation Equipment". The term "mobile transportation equipment" includes only equipment for use in transporting persons or property for substantial distances. The term does not include items of a kind commonly used only in loading or unloading persons or property, or short distance moving within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport. Examples of such items are hand dollies, forklift trucks, mine cars, pilot boats, tugboats and lighters, not including, however, lighters or barges specifically designed to be carried regularly aboard vessels for substantial distances. The term does include pickup	Regulation 1661 (a) Definitions. (1) "Mobile Transportation Equipment". The term "mobile transportation equipment" includes only equipment for use in transporting persons or property for substantial distances, <u>such as railroad cars and locomotives, buses, trucks (except "one-way rental trucks"), truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment.</u> The term does not include items of a kind commonly used only in loading or unloading persons or property, or short distance moving within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport.	<i>No Change to the Existing Regulation</i>	Regulation 1661 (a) Definitions. (1) "Mobile Transportation Equipment". The term "mobile transportation equipment" includes only equipment for use in transporting persons or property for substantial distances, <u>such as railroad cars and locomotives, buses, trucks (except "one-way rental trucks"), truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment.</u> The term does not include items of a kind commonly used only in loading or unloading persons or property, or short distance moving within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport.	Although not included in Water Resorts' proposal, Water Resorts has no objections to this amendment.

**Application of Tax to Leases of Houseboats under Regulation
1661, Leases of Mobile Transportation Equipment
Comparison of Current and Proposed Language**

Revised as of March 13, 2000

Action Item	Current Regulatory Language	Staff's Proposed Language (Recommended)	Water Resorts Proposed Language (Alternate 1)	Staff Drafted Language (Alternate 2)	Summary Comments
	<p>trucks and tangible personal property which is or becomes a component part of mobile transportation equipment.</p> <p>The following items are specifically excluded from the definition of mobile transportation equipment:</p> <p>(A) Passenger vehicles as defined in section 465 of the California Vehicle Code;</p> <p>(B) Trailers and baggage containers designed for hauling by passenger vehicles; and</p> <p>(C) One-way rental trucks. These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, not</p>	<p>Examples of such items are hand dollies, forklift trucks, mine cars, pilot boats, tugboats and lighters, not including, however, lighters or barges specifically designed to be carried regularly aboard vessels for substantial distances. The term does include pickup trucks and tangible personal property which is or becomes a component part of mobile transportation equipment.</p> <p>The following items are specifically excluded from the definition of mobile transportation equipment:</p> <p>(A) Passenger vehicles as defined in section 465 of the California Vehicle Code;</p> <p>(B) Trailers and baggage containers designed for hauling by passenger vehicles; and</p> <p>(C) One-way rental trucks. These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, not</p>		<p>Examples of such items are hand dollies, forklift trucks, mine cars, pilot boats, tugboats and lighters, not including, however, lighters or barges specifically designed to be carried regularly aboard vessels for substantial distances. The term does include pickup trucks and tangible personal property which is or becomes a component part of mobile transportation equipment.</p> <p>The following items are specifically excluded from the definition of mobile transportation equipment:</p> <p>(A) Passenger vehicles as defined in section 465 of the California Vehicle Code;</p> <p>(B) Trailers and baggage containers designed for hauling by passenger vehicles; and</p> <p>(C) One-way rental trucks. These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, not</p>	

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	<p>exceeding the manufacturer's gross vehicle weight rating of 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short-term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or being employed in this state by the person, are identified to the board by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased and maintaining records which can be verified by audit of the vehicles as to which such an election has been made.</p> <p>Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and any taxes which are imposed are measured by the rentals. Once a truck is identified to</p>	<p>exceeding the manufacturer's gross vehicle weight rating of 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short-term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or being employed in this state by the person, are identified to the board by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased and maintaining records which can be verified by audit of the vehicles as to which such an election has been made.</p> <p>Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and any taxes which are imposed are measured by the rentals. Once a truck is identified to</p>		<p>exceeding the manufacturer's gross vehicle weight rating of 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short-term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or being employed in this state by the person, are identified to the board by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased and maintaining records which can be verified by audit of the vehicles as to which such an election has been made.</p> <p>Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and any taxes which are imposed are measured by the rentals. Once a truck is identified to</p>	

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	<p>the board as a one-way rental truck, the election may not be revoked with respect to the equipment as to which it is made. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.</p> <p>(2) "Bogie". The term "bogie" means a vehicle consisting of an axle or axles with wheels and tires with a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed so as to allow a sliding movement under a container (or van body) to several positions under the container to adjust to desired axle loading.</p>	<p>the board as a one-way rental truck, the election may not be revoked with respect to the equipment as to which it is made. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.</p> <p>(2) "Bogie". The term "bogie" means a vehicle consisting of an axle or axles with wheels and tires with a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed so as to allow a sliding movement under a container (or van body) to several positions under the container to adjust to desired axle loading.</p>		<p>the board as a one-way rental truck, the election may not be revoked with respect to the equipment as to which it is made. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.</p> <p>(2) "Bogie". The term "bogie" means a vehicle consisting of an axle or axles with wheels and tires with a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed so as to allow a sliding movement under a container (or van body) to several positions under the container to adjust to desired axle loading.</p>	

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Action Item	Current Regulatory Language	Staff's Proposed Language (Recommended)	Water Resorts Proposed Language (Alternate 1)	Staff Drafted Language (Alternate 2)	Summary Comments
	<p>(3) "Chassis". The term "chassis" means a frame with one or more axles designed to be used in conjunction with and as a temporary support or undercarriage for a container or other van-type box. The chassis and axle or axles may be designed and constructed so as to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.</p> <p>(4) "Dolly". The term "dolly" means a vehicle consisting of a tongue, fifth wheel and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.</p>	<p>(3) "Chassis". The term "chassis" means a frame with one or more axles designed to be used in conjunction with and as a temporary support or undercarriage for a container or other van-type box. The chassis and axle or axles may be designed and constructed so as to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.</p> <p>(4) "Dolly". The term "dolly" means a vehicle consisting of a tongue, fifth wheel and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.</p>		<p>(3) "Chassis". The term "chassis" means a frame with one or more axles designed to be used in conjunction with and as a temporary support or undercarriage for a container or other van-type box. The chassis and axle or axles may be designed and constructed so as to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.</p> <p>(4) "Dolly". The term "dolly" means a vehicle consisting of a tongue, fifth wheel and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.</p>	

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	When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a "full" trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle or axles equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.	When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a "full" trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle or axles equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.		When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a "full" trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle or axles equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.	

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ACTION 2 - 2. Add language specifying that houseboats do not qualify as mobile transportation equipment.	(5) "Ships" The term "ships" includes vessels 30 feet or more in length. The term does not include vessels less than 30 feet in length.	(5) "Ships" The term "ships" includes vessels 30 feet or more in length <u>for use in transporting persons or property for substantial distances.</u> The term does not include vessels less than 30 feet in length, <u>or houseboats, whether or not they are 30 feet or more in length.</u>	<i>No Change to the Existing Regulation</i>	(5) "Ships" The term "ships" includes vessels <u>such as trawlers, fishing boats, sailboats, and yachts</u> 30 feet or more in length. <u>The term also includes houseboats 30 feet or more in length that are purchased on or after January 1, 2001.</u> The term does not include vessels less than 30 feet in length.	Staff's recommendation is that language should be added to the regulation to clarify that houseboats are not mobile transportation equipment. Water Resorts believes that houseboats should be treated in the same manner as other vessels. They propose making no change to Regulation 1661 and administratively recognizing houseboats 30 feet or more in length as mobile transportation equipment. If the Board concludes that houseboats are ships and, thus, are MTE when 30 feet or more in length, staff recommends amendments to Regulation 1661(a)(5) be adopted as drafted by staff, with an operative date of January 1, 2001.

Regulation 1661. Leases of Mobile Transportation Equipment.

Reference: Sections 6006, 6006.1, 6006.3, 6006.5, 6009, 6010, 6010.1, 6011, 6012, 6016.3, 6023, 6024, 6092.1, 6094, 6243.1, 6244, 6352, 6390, 6391, 6407 and 6457, Revenue and Taxation Code.

(a) Definitions.

(1) "Mobile Transportation Equipment". The term "mobile transportation equipment" includes only equipment for use in transporting persons or property for substantial distances, such as railroad cars and locomotives, buses, trucks (except "one-way rental trucks"), truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment. The term does not include items of a kind commonly used only in loading or unloading persons or property, or short distance moving within the confines of a limited area, such as a loading dock, warehouse, terminal, bay or airport. Examples of such items are hand dollies, forklift trucks, mine cars, pilot boats, tugboats and lighters, not including, however, lighters or barges specifically designed to be carried regularly aboard vessels for substantial distances. The term does include pickup trucks and tangible personal property which is or becomes a component part of mobile transportation equipment.

The following items are specifically excluded from the definition of mobile transportation equipment:

(A) Passenger vehicles as defined in section 465 of the California Vehicle Code;

(B) Trailers and baggage containers designed for hauling by passenger vehicles; and

(C) One-way rental trucks. These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, not exceeding the manufacturer's gross vehicle weight rating of 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short-term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or being employed in this state by the person, are identified to the board by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased and maintaining records which can be verified by audit of the vehicles as to which such an election has been made.

Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and any taxes which are imposed are measured by the rentals. Once a truck is identified to the board as a one-way rental truck, the election may not be revoked with respect to the equipment as to which it is made. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.

(2) "Bogie". The term "bogie" means a vehicle consisting of an axle or axles with wheels and tires with a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically

Leases of Mobile Transportation Equipment.

designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed so as to allow a sliding movement under a container (or van body) to several positions under the container to adjust to desired axle loading.

(3) "Chassis". The term "chassis" means a frame with one or more axles designed to be used in conjunction with and as a temporary support or undercarriage for a container or other van-type box. The chassis and axle or axles may be designed and constructed so as to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.

(4) "Dolly". The term "dolly" means a vehicle consisting of a tongue, fifth wheel and axle equipped with wheels and tires to be connected to a semitrailer so as to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.

When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a "full" trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle or axles equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.

(5) "Ships" The term "ships" includes vessels 30 feet or more in length for use in transporting persons or property for substantial distances. The term does not include vessels less than 30 feet in length, or houseboats, whether or not they are 30 feet or more in length.

(b) Application of Tax.

(1) With respect to leases of mobile transportation equipment, the sale to the lessor is the retail sale and the lessor is the consumer of the equipment. Accordingly, either the sale of the equipment to the lessor or its use in this state may be subject to tax. For example, if the sale and delivery occur within California, the transaction is subject to sales tax unless the lessor makes a timely election to report his or her tax liability measured by the fair rental value as provided in (b)(2) below. On the other hand, if the sale and delivery occur outside California and the property is purchased for use in California, use tax will apply measured by the purchase price unless the equipment enters the state in interstate commerce and is used continuously thereafter in interstate commerce, or the lessor makes a timely election to report use tax liability measured by the fair rental value as provided in (b)(2) below.

If in connection with an assignment of an existing lease of mobile transportation equipment, title to the leased property is transferred to the assignee, the transfer is a sale to the assignee and the assignee is the consumer of the equipment. Application of tax is governed by the rules set forth in this section (b)(1).

(2) If the use of mobile transportation equipment purchased under a resale certificate is limited to leasing the equipment, the purchaser may elect to pay his or her use tax liability measured by the fair rental value if the election is made on or before the due date of a return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on a timely return for that period. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made. Any separately stated amount collected from a lessee by a lessor electing to report use tax measured by fair rental value under the representation by the lessor that the amount is use tax imposed on the customer must be returned to the customer or paid to the board. A designation by the lessor of a separately stated amount as "use tax", without further explanation, will be regarded as a representation that the amount is use tax imposed on the customer.

This election is available to any purchaser who leases mobile transportation equipment, other than a person exempt from use tax under Revenue and Taxation Code Section 6352, and such purchaser may properly issue a resale certificate for the limited purpose of reporting use tax liability based on fair rental value.

(A) Fair Rental Value. "Fair rental value" means the rentals required by the lease, except where the Board determines the rental receipts are nominal. Fair rental value does not include any payment made by the lessee to reimburse the lessor for the lessor's use tax, whether or not the amount is separately stated, and regardless of how the charge is designated in the lease documentation and invoices. Lump-sum charges to the lessee will be assumed to include reimbursement for the lessor's use tax whether or not any statement to that effect is made to the lessee.

Example:

Assuming a 6 percent tax rate, if the invoice to the lessee states "rental \$100, tax reimbursement to the lessor \$6", "rental \$100, sales and use taxes \$6", or similar wording, the fair rental value is \$100. If the invoice to the lessee states "rental \$106" and makes no reference to reimbursement, the fair rental value is \$100 (\$106 divided by 1.06). Assuming a 6.5 percent tax rate, the fair rental value is \$99.53 (\$106 divided by 1.065).

Fair rental value includes any deficiency payment required from the lessee on disposition of mobile transportation equipment at the termination of an open-end lease and such payment is subject to tax. Any surplus rentals, however, which are returned to the lessee at the termination of an open-end lease may be deducted from the total fair rental value reported for the period in which the surplus rentals are returned. In the alternative, a refund may be claimed for any tax paid within the applicable statute of limitations period on such surplus rentals.

Fair rental value includes any capitalized cost reduction payment, which is a one-time payment by the lessee at the start of the lease to reduce the lessor's investment and the lessee's rentals. The payment may either be reported for the period in which it became due from the lessee or it may be reported in equal increments over the lease term. On early termination of such a lease, any unreported portion of the capitalized cost reduction payment shall be reported for the period in which termination occurred.

The term "fair rental value" includes any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but do not include amounts paid to the lessor for:

(1) Collection costs, including attorney's fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected by court action;

(2) Insuring, repairing or refurbishing the leased property following a default;

(3) Costs incurred in defending a court action or paying a tort judgement arising out of the lessee's operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgements;

(4) Costs incurred in disposing of the leased property at expiration or earlier termination of the lease.

(5) Late charges and interest thereon for failing to pay the rentals timely;

(6) Separately stated optional insurance charges, maintenance or warranty contracts.

(B) Tax Application. Tax applies to fair rental value for all periods during which the mobile transportation equipment is leased even though the lessee may not make the required rental payments. The lessor must pay tax at the rate in effect at the time the equipment is first leased. The tax rate will remain the same for all periods during which the equipment is leased, including the periods during the first lease of the equipment and all periods during any subsequent leases of the equipment.

Tax on fair rental value does not apply either (a) for periods during which the equipment is not leased and is merely held for lease; or (b), for periods after the lessor has formally demanded return of the equipment if the lessee wrongfully retains possession of the property and is not required to make rental payments under the lease. If mobile transportation equipment is sold while subject to an existing lease and the new purchaser elects to pay tax measured by fair rental value, the applicable tax rate during the existing lease and during all subsequent leases is the rate in effect at the time of the sale of the mobile transportation equipment to the new purchaser.